

Restricted Stock & Restricted Stock Units

Bruce Brumberg, Editor-in-Chief

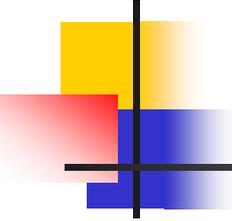
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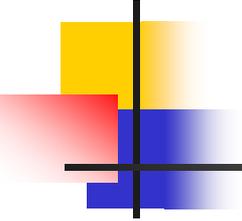
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Restricted stock grant v. stock options

- Historically, often part of senior executives' comp, alongside options.
- Popularity with institutional investors runs in cycles: restricted stock is often derided as having little motivational power (“pay for a pulse”).
- Has been most useful in employee recruitment/retention when leaving behind valuable options or when the stock price is flat.
- Big increases in grants at levels below senior management, although not as broadly granted as options.
- Now the top alternative to stock options, whether granted instead of or in combination with options.
- Accounting treatment becomes similar between types of equity compensation: “level playing field.”
- Less dilution than with options because fewer granted.
- Value in down and volatile markets: never underwater, gets dividends, but less upside compared with options.



Bill Gates on the move from options to restricted stock at Microsoft: less risk for you than stock options

- “When you win [with options], you win the lottery. And when you don't win, you still want it. The fact is that the variation in the value of an option is just too great.”
- “I can imagine an employee going home at night and considering two wildly different possibilities with his compensation program. Either he can buy six summer homes or no summer homes. Either he can send his kids to college 50 times, or no times.”
- “The variation is huge; much greater than most employees have an appetite for. And so as soon as they saw that options could go both ways, we proposed an economic equivalent. So what we do now is give shares, not options.”

Restricted Stock

- ▶ Basics
- ▶ Advanced
- ▶ Restricted Stock Units
- ▶ Performance Shares
- ▶ Taxes
- ▶ Taxes Advanced
- ▶ Section 83(b)

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Tax errors can be costly! Don't draw unwanted attention from the IRS. Our **Tax Center** explains and illustrates the tax rules for sales of company stock, W-2s, withholding, estimated taxes, AMT, and more.



Restricted Stock

Restricted stock, RSUs, and performance shares have become prominent forms of stock grant. Browse an overview of this section below, or explore the subtopics to the left.

In addition to the main areas about basic and advanced topics in all these types of grants, see the special subsections that are exclusively about [restricted stock units](#) and [performance shares](#).

 Test and improve your knowledge with our [Restricted Stock & RSUs](#) quiz and its study guide in the answer key.

 Want to know more? Got a few minutes? Listen to our new [podcast](#) on restricted stock and restricted stock unit basics!

Articles

FAQs

▶ **Stockbrokers' Secrets (Part 8): What I Tell My Clients About Their Restricted Stock And Performance Shares** [mso+](#)

W.E.B. Bantling

NEW! Many companies have turned away from stock options and begun to make outright stock grants that must vest before the shares can be issued. For employees, these grants have added a new layer of complexity to their equity compensation. This article presents six questions I get all the time from clients who have received restricted stock, restricted stock units, or performance shares.

▶ **Restricted Stock Units Made Simple (Part 1): Understanding The Core Concepts**

Matt Simon

Restricted stock units (RSUs) have become the most popular alternative to stock options. While RSUs share many of the same issues as restricted stock, there are differences, and it is important to understand the basics of RSUs in their own right.

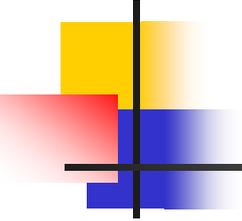
▶ **Restricted Stock Units Made Simple (Part 2): Taxation** [mso+](#)

Matt Simon

Articles & FAQs on myStockOptions.com explain everything you need to know about restricted stock & RSUs.

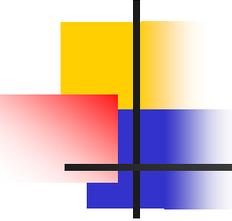


Learn the rules and limits of restricted stock.



What's the restriction?

- Confused with restricted securities (i.e. unregistered stock), performance shares, or outright grants. Better term is “unvested stock grants” or “full value shares.”
- Restricted because you cannot sell stock until it has vested. Not yet fully “owned” in the traditional sense.
- Vested: when sale restrictions lapse.
- Lapse: no longer subject to “substantial risk of forfeiture.”
- Private companies: presentation not on early-exercise, pre-IPO options in which you get restricted stock at exercise. (See the section **[Pre-IPO: Early-Exercise Options](#)** on myStockOptions.com.)



Vesting: key concept

- No money paid to company (no exercise) . Not exercising to own stock, as with options (unless pre-IPO early-exercise options/paying money).
- After vesting, you own the shares, as with stock bought on the open market. Taxes triggered when shares vest.
- Time-based most popular. Not eligible for performance-based exception under rules that limit deduction for compensation over \$1 million [Section 162(m)].
- Performance targets: can trigger or accelerate vesting, and performance goal must be related to company. Performance shares are popular for senior executives.
- Termination: forfeit unvested shares.



Test Your Knowledge: Restricted Stock & Restricted Stock Units Quiz

Test your knowledge of restricted stock and restricted stock units. Please answer the following 10 questions. This quiz is also a course of study. The answer key links to content on the topic for follow-up reading.

[Skip the quiz and view the answers](#)

1. **What is restricted stock?**

- A type of stock option
- The collective term for a grant of stock units
- A grant of company stock you must register with the SEC
- A grant of company stock that you cannot sell until vesting

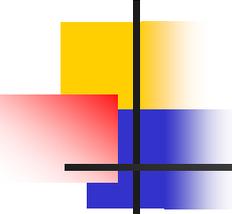
2. **How long after grant does restricted stock usually expire?**

- It never expires, unless your employment ends before vesting
- 10 years, unless your employment ends before vesting
- 10 years, regardless of whether your employment ends before vesting
- When you retire

3. **What happens to vested restricted stock?**

- 50% of the stock is rolled into another company benefit, usually a 401(k)
- The stock becomes yours to hold or sell after a lockup period of 180 days

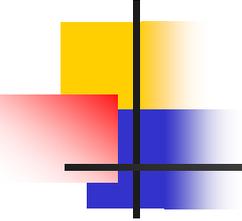
Fun interactive quizzes on restricted stock/RSUs



Grant size: tradeoffs

Full value of shares at vesting (not spread since grant), so fewer shares than in an option grant. The volatility of your company's stock and any dividend affect the value of restricted stock in comparison with stock options. Observations by consultants about the tradeoff ratios :

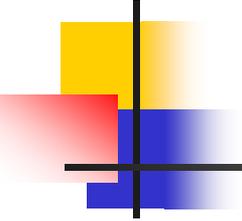
Type of company	Ratio
High volatility / no dividends (e.g. technology)	1 restricted share for 3 or 4 option shares
Moderate volatility / moderate dividend yield	1 restricted share for 4 or 5 option shares
Low volatility / high dividend yield	1 restricted share for 6 or 7 option shares



Tax treatment different from that of options: two alternatives

Standard: pay tax at vesting

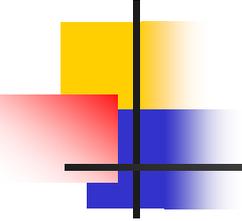
- Taxed as ordinary income at vesting when forfeiture risk removed (with options not taxed at vest).
- Taxable income is the value of the stock when each slice vests. Stock price at grant does not matter unless second tax treatment alternative.
- If you sell the stock, you have capital gains or losses as with the sale of any shares.
- Tax basis is the amount you included in income as compensation.
- Capital gains holding period begins at the time of vesting.
- See **[Restricted Stock: Taxes](#)** and **[Restricted Stock: Taxes Advanced](#)**.



Example: let shares vest

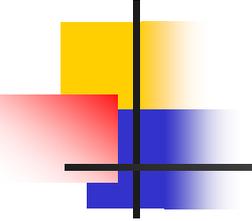
4,000 shares of restricted stock that vest at a rate of 25% a year; grant market price at \$18.

- year one: \$20 (1,000 x \$20 = \$20,000 of ordinary income)
 - year two: \$25 (\$25,000)
 - year three: \$30 (\$30,000)
 - year four: \$33 (\$33,000)
 - total: \$108,000
-
- Each increment is taxable on its vesting date.
 - Sell all the stock two years after the last shares vest, when the price is \$50 (\$200,000 for the 4,000 shares).
 - Capital gain is \$92,000 (\$200,000 minus \$108,000).



Second tax treatment: 83(b) elections

- Make a Section 83(b) election with the IRS within 30 days of the grant. Not available for RSUs.
- No special tax form for a Section 83(b) election.
- You send the local IRS office your election with information that identifies you and the property you include in your income. Still attach a copy of the election when you file your return.
- Pay taxes on the value of all the stock at grant.
- Remember: you cannot sell any shares until they vest.
- Almost impossible to rescind election.
- Advantage: tax for compensation income will (hopefully) be lower and start capital gains holding period.

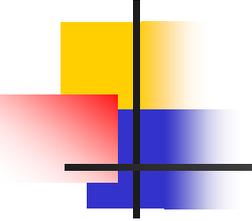


Example with 83(b) election

Same facts of the previous example for appreciating stock.

You make a timely 83(b) election at grant:

- Compensation income of \$72,000 ($4,000 \times \18).
- Capital gain of \$128,000 at sale
(\$200,000 minus \$72,000).
- Election allowed you to convert \$36,000 of ordinary income to the lower-taxed capital gains (\$128,000 = \$92,000 of capital gain in the prior example plus \$36,000 that was ordinary income without the 83(b) election).



Risk with election

- You left the company: restricted stock never vested.
- You cannot rescind your election or recover the taxes you paid.
- Stock price dropped by vesting: you cannot recover taxes paid with 83(b) election.
- You might be better off with using the tax dollars to buy stock on open market. Need to run the numbers with your advisor.

**Article on
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explains the analysis.**

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Restricted Stock: Section 83(b)

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Decisions At Grant With Restricted Stock (Part 2): The 83(b) Election Risks

[ms0+](#)

Tom Davison

In [Part 1](#), we examined the basic facts of restricted stock and the decisions you need to make at grant. One of the biggest decisions is the choice to be taxed either at grant or at vesting. You can choose to be taxed at grant with a Section 83(b) election (this choice is unavailable with RSU grants). This article explains the risks of the election.

Decision Alternatives At Grant

You have three alternatives when the grant is made:

1. Make an 83(b) election for all or part of the grant, paying taxes up front.
2. Take the up-front cash that you would otherwise use to pay the taxes and invest in a diversified portfolio.
3. Take the up-front cash that you would otherwise use to pay the taxes and invest in more shares of your company stock.

Risks Of The 83(b) Election

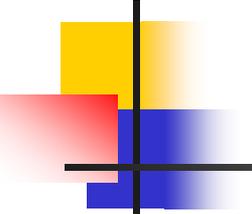
Let's look at the risks of an 83(b) election.

Risk Of Job Loss

One risk stems from loss of job between grant and vesting: for example, if you left for a better job or were fired. In this case, the stock would never vest, so you would never own it outright.

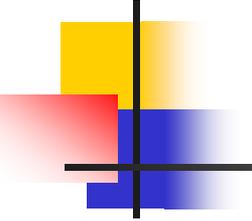
With the up-front 83(b) election, you would lose the taxes you paid. No deduction is available to recover the prepaid taxes. You don't receive the stock, so there is nothing to sell for a capital loss.

Example with loss of job: You are granted 1,000 shares of stock at \$20 a



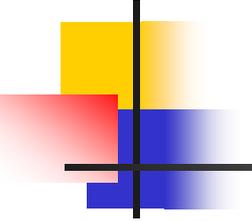
Withholding taxes on restricted stock

- Subject to tax withholding at vesting or 83(b) filing.
- Compensation income similar to NQSO treatment on spread at exercise. Familiar [W-2 reporting](#).
- Amount is withheld from salary, cash payment made, or sell-to-cover taxes, or the company may allow (or require) share withholding.
- Company needs to have the cash to use automatic share withholding/surrender, as no shares sold to generate funds need to pay IRS.
- With share withholding/surrender, employees may be confused about reporting of securities sales on Schedule D of tax return. At the least, do not withhold shares in Schedule D reporting when remaining shares sold (see the [Tax Center](#) on myStockOptions.com).



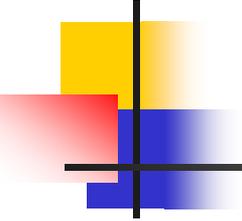
Withholding taxes on restricted stock

- Clear dates where actions and transactions will be occurring. Company needs to make decisions on: communications about 83(b) election at grant; withholding/lapse election process at vesting; timing for notifications on choices for withholding; what to do if no election made; elections on what to do with stock and cash
- Senior executives and directors Form 4 filing if share withholding at vesting even though no shares are “sold” into market. Normally file form 4 with grant and then with stock sale, not at vesting.
- Companies sometimes consider **Rule 10b5-1 trading plans** to cover share withholding.
- **ALERT:** Companies can no longer lend senior executives or directors the necessary funds for tax withholding or for buying restricted stock.



Restricted stock accounting

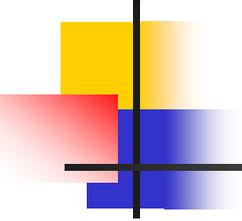
- Earnings charge fixed according to grant date value spread out over vesting/restriction lapse dates, unless 83(b) election made. No use of option valuation models.
- Timing for tax deduction and earnings charge match taxable compensation to employee when yearly vesting.
- More complex areas: estimates on forfeitures; deferred tax accounting; performance-vesting provisions (e.g. shares that may never vest).



Accounting example

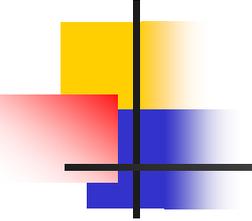
4,000 shares of restricted stock vest at 25% a year (1,000 shares yearly); grant market price at \$18 and no 83(b) election.

- year one: stock price \$20 (1,000 x \$18 = \$18,000 earning charge and \$20,000 tax deduction)
- year two: \$25 (\$18,000 charge, \$25,000 deduction)
- year three: \$30 (\$18,000 charge, \$30,000 deduction)
- year four: \$33 (\$18,000 charge, \$33,000 deduction)
- 83(b) election to be taxed at grant: \$72,000 earnings charge and tax deduction



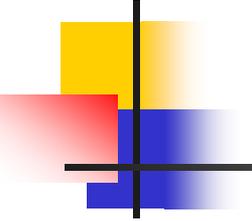
Dividends on restricted stock

- Dividends on unvested shares are compensation income reported on W-2. They are not “qualified dividends,” which are taxed at lower rates until vested.
- Dividends on 83(b) election are reported on 1099-DIV.
- Approximately 10% pay dividends in more shares, although not received until underlying shares vest.



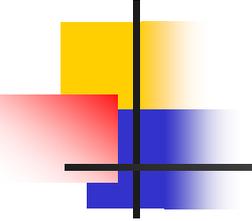
Restricted stock units: used by Amazon, Microsoft, and GE

- Stock itself is not issued or outstanding until the actual release of the shares at vesting.
- Holders of RSUs have no voting rights.
- Dividends (i.e. equivalents) not required as RSU-holders are not shareholders. May be dividend equivalents based on the plan details.
- Microsoft does not pay dividends on RSUs. Made adjustments with large dividend payment. General Electric does pay dividends.



Restricted stock units: used by Amazon, Microsoft, and GE

- Share delivery occurs at vesting in broad-based plans, with share withholding for the taxes.
- Specialized RSU plans have a **deferral feature** that lets you select a date for share delivery, or one is specified by the company (e.g. retirement). Ordinary income tax, delayed until delivery of shares.
- With these deferral elections, you must follow all the guidance on timing and the procedures under IRC Section 409A on deferred compensation.
- Social Security and Medicare at vesting with deferrals.



Why use RSUs instead of restricted stock for grants?

- Eliminates 83(b) election. No administrative burdens for company and employee risks.
- Can avoid paying cash dividends during the vesting period.
- RSUs avoid tax at grant in countries where tax is not delayed until vesting.
- RSUs **do not** avoid the administrative issues for withholding taxes at vesting.
- Specialized RSU plans defer delivery of the shares (not at vesting) until date specified by executives or termination of employment.

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myRecords is the online record-keeper and portfolio-tracker for employee stock options (nonqualified and incentive), restricted stock, restricted stock units (RSUs), and stock appreciation rights (SARs).

- Store and view grant data, including vesting and expiration dates. Helpful "wizards" speed up data entry.
- Model stock-price changes and "as of" dates to see total value and total gain.
- Sort grants by next vest date, expiration date, grant type, and other features, with separate presentations for restricted stock and SARs.
- Grant information feeds our calculators and modeling tools.
- Export grant data to an Excel file ([MSO Pro Members](#) can also import data from Excel files).

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